Testimony of

Edmund F. Kelly

Chairman, President and Chief Executive Officer

Liberty Mutual Group

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Liberty Mutual appreciates the opportunity to submit this testimony in support of a long-term commitment to continue the public-private partnership that is the essence of the Terrorism Risk Insurance Act of 2002 (TRIA) and its successor, the Terrorism Risk Insurance Extension Act of 2005 (TRIEA). Rather than another short-term extension, we urge the Committee – on behalf of our customers, many of them employers and property owners here in New York City – to move quickly to meet the long-term terrorist challenge facing our nation.

A critical aspect of that challenge is to provide a durable bulwark against the potentially devastating economic consequence of a terrorist attack. The insurance mechanism can play a key role – as it did, profoundly, following September 11th – providing the financial resources to help people rebuild their lives and livelihoods following a terrorist attack. A long-term extension of TRIEA will enable the insurance industry to continue to perform this vital role. Without TRIEA, the industry's ability to serve its customers by providing the financial protection they need and deserve will be severely compromised and our nation's economy put at significant risk. Without a long-term TRIEA we will continue to be faced with the periodic disruptive effect of the uncertainty as to the availability of coverage.

There is no longer any serious debate that available terrorism risk insurance is an essential ingredient of our national defense against terrorism. The only question is the relative role of the federal government versus the private market. Liberty Mutual believes that the current law – the Terrorism Risk Insurance Extension Act – strikes an appropriate balance. Congress has acted wisely in constructing legislation that relies to the greatest degree possible on the private insurance and reinsurance markets, although, as I will discuss, there are a few areas that need improvement or clarification. As a strong proponent of the private market's ability to respond to and manage financial risks, if we thought that TRIEA interfered in any way with the development of a private market for terrorism risk, we would be the first in line to call for its repeal. We are confident that without TRIEA there would be far less coverage available for terrorism risk and no voluntary coverage available for nuclear and related risks of mass destruction. It is the existence of TRIEA that enables the industry to offer terrorism risk coverage today…and so we call on this Committee and the Congress to pass a long-term extension of TRIEA .

For several reasons outlined below, a significant public-private partnership is essential for ensuring the availability of terrorism risk insurance.

UNDERSTANDING THE USE OF INSURANCE CAPITAL

Some people have suggested that since capital within the insurance industry is roughly $675 billion, the industry has sufficient capacity to assume the risk of terrorism. These estimates, however, include capital in the life, home, and auto insurance industry, which is not available for the terrorism risk addressed by TRIEA—as well as capital that underpins other business line risks. For example, at Liberty Mutual we have $12 billion in policyholder surplus, which supports all our policyholders including homeowners exposed to hurricane risk, automobile owners exposed to accidents, workers exposed to lost time and medical expense from workplace accidents, and others; our surplus is not just set aside to cover exposure to terrorist events.

Many terrorism loss scenarios are modeled at costs exceeding $100 billion and some very plausible events at $700 billion or more. Yet, the entire property and casualty insurance industry has only an estimated $151 billion of capital backing all risks - including fire, wind, accident or other insured perils - covered by TRIEA-backstopped policies.

Without TRIEA, there is the very real potential that terrorism-related losses would overwhelm the industry's ability to pay its customers' losses.

There are limited sources of new capital.

Sources of new capital are few and limited. Organic growth (operating income and investment returns) is slow, subject to taxation, and inadequate to the terrorism risk. This is true despite significant earnings across the industry in 2006 – even many years of strong earnings would be insufficient to build the capital base necessary to assume the risk of catastrophic terrorist-caused loss. The capital markets will not provide the answer, they are limited by prudent financial management, investors, regulators and rating agencies. Despite demand there has been minimal interest in Terrorism-Catastrophe bonds, unlike the case for hurricane catastrophes. Reinsurance is an option but global capacity is very limited for terrorism risk (estimated $6-8 billion) and almost none exists for NBCR (nuclear, biological, chemical, and radiological risk).

OPERATING IN A HIGHLY REGULATED MARKET

Some critics of TRIEA suggest government should get out of terrorism insurance completely. They say: let the free market handle terrorism. At Liberty Mutual, we fully believe free markets are better. Wherever we operate, we push hard for free markets. But terrorism insurance is not a free market. In a free market, providers of products and services compete to sell those products and services. If the terms, conditions, or prices are inadequate, or if the risk of loss is too large, the provider has the option to withdraw. We cannot withdraw from terrorism insurance. For example, in each and every state (as discussed further below) workers compensation must cover all loss from terrorism. If pricing is inadequate, or exposure too great, the only way to avoid the risk is to completely withdraw from the workers compensation market.

Highly-Regulated Markets Present Distinct Challenges

Insurers operate in highly regulated environments. State insurance laws and regulations constrain capital and significantly limit the choices insurers can make to protect themselves from essentially unlimited terrorism exposure. Workers compensation is a particularly good example. Under state workers compensation laws, employers must purchase coverage to protect their employees. Insurers that provide this critically important insurance are required to do so without exclusions or limits of any kind. Thus the potential for large losses from terrorism, even for a single employer, can be very great. For example, the value of survivor's benefits for a 42-year-old spouse with two children is about $4 million in Massachusetts. A terrorist attack resulting in 1,000 deaths at a Liberty Mutual insured workplace in Massachusetts could cost us $4 billion – or about a third of our policyholder surplus. As we learned in 2001, not very far from here, 1,000 deaths or more from a single terrorist attack is a very real risk.

Regulatory requirements on commercial property insurance further accentuate the challenge. Insurers face mandatory "fire following" coverage in standard fire policies in

Alternative is Reduced Exposure to Terrorism Risk

In the absence of TRIEA or a similar public-private partnership, insurers would be unable to add sufficient capacity from private sector sources; therefore, we would have to significantly reduce exposure to terrorism risk. First, we could try to reduce exposure by using coverage exclusions or limits. But, as discussed, those tools are not available anywhere in workers compensation or for property insurance in certain standard fire policy states. Second, we could manage risk concentrations to ensure against over-exposure to terrorism risk in certain customer locations and geographic areas. To do so, we would utilize geo-coding and other data on the number of policies, employees, and property values in specific locations. To keep concentrations low, we would shed risk by ceasing to write certain risks in certain areas or by not renewing existing coverages. These choices, while not made easily, would be necessary in the absence of TRIEA, and would also have a hugely negative effect on the economy, as businesses would be unable to get needed insurance coverage.

RISK OF RUIN

Since company deductibles are so large, TRIEA would reimburse the industry only if a truly significant event occurred. At Liberty Mutual for example, our TRIEA deductible is $1.6 billion. A backstop that protects us from a loss exceeding such a large deductible is hardly a handout – especially considering we're offering coverage we would otherwise not offer, or would offer on significantly different terms.

So the challenge moving forward is to create a mechanism that achieves two goals. First, to make certain needed insurance is available for economic growth by creating a structure in which insurance companies can write the coverages businesses need to manage their risk without exposing themselves to financial ruin. And second, we need a vehicle that encourages the private market to develop financial responses to terrorism.

LONG-TERM TERRORISM RISK INSURANCE PROGRAM

Liberty Mutual believes that TRIA and TRIEA have worked exactly as intended to promote the availability of terrorism risk insurance at commercially reasonable prices. This essential public-private partnership should be extended on substantially the same terms as it was conceived in 2002 and amended in 2005 for as long as the terrorist threat persists.

The structure of TRIEA is sound. By establishing a per-company "deductible," each company is responsible for its own underwriting decisions. Unlike pools or similar mechanisms that distort the market by forcing some companies to live with the bad underwriting decisions of others, TRIEA defines the level of risk to be managed by the private market – one company at a time. After all, the industry doesn't write insurance – individual companies do. We urge the Committee to keep the current structure of TRIEA intact.

However, we believe serious consideration should be given to improving TRIEA in three important ways:

First, extend the law indefinitely – or until the President determines that the threat of terrorism to the homeland has ceased. Short-term extensions cause market uncertainty as sellers can't offer and buyers can't depend on coverage for terrorist risk. This is particularly disruptive of large scale, long duration real estate projects, but it also has negative consequences across the commercial markets.

Second, eliminate the artificial distinction between foreign and domestic terrorism. If the purpose of the law is to provide economic stability by maximizing use of the private insurance mechanism, it makes no sense to exclude from that protection acts of domestic terrorism.

Third, consider removing or enlarging the program cap at least as it relates to nuclear, biological, chemical, and radiological risk, and clarify that private companies have no responsibility for NBCR losses above $100 billion, once they have met their own deductibles. Simply put, NBCR risk is not insurable in the private market. Only the federal government has the responsibility and the resources to respond.

The potential human and economic consequences of an NBCR event are frightening. According to modeling by the American Academy of Actuaries, a single large-scale NBCR attack has the potential to cause insured losses of $700 billion or more depending on weapon type and location. A medium scale NBCR attack in a major U.S. city could result in insured losses in excess of $100 billion. Beyond the costs of compensation, NBCR attacks would disrupt the economy and shut off sources of insurance industry capital to pay current and future claims – both related to the terrorist event and the ongoing claims. Moreover, losses from NBCR attacks could take years to quantify. Unlike damages from conventional attacks, NBCR damages will take much longer to determine given the latent nature of potential injuries. Also, the public's reaction to such an event can bring additional, yet unforeseen economic and emotional damages. Such extreme and long-term uncertainty means the insurance industry cannot assume the risk.

Given the unique properties of NBCR risk, insurers and reinsurers have historically excluded such risk from their contracts. The major exceptions are workers compensation and, in some states, property insurance where exclusions by primary insurers are not permitted – although reinsurers routinely exclude all NBCR. NBCR risk remains outside the capability and capacity of the insurance industry. Thus, NBCR risk should receive differential treatment, distinct from the risk of conventional terrorism, in any legislative successor to TRIEA.

We believe that these improvements to TRIEA – long-term extension, coverage for domestic terrorism, and expanded federal role for NBCR risk – effectively and fairly balance the public and private roles. The private market remains responsible for both conventional and NBCR risk up to its aggregate deductible and co-pay – roughly $42.5 billion - and is subject to potential surcharges for any federal dollars expended up to $100 billion. The federal government acts as a high level backstop in the case of conventional terrorism risk, and assumes an appropriately larger role in the case of a nuclear or similar attack.

Liberty Mutual is committed to working with this Committee and others in our industry and in the policyholder community to establish a public/private partnership that makes terrorism insurance coverage available for the long-term.

Thank you.